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Thoughts on the Crisis

By Lionel Robbins

I

ONE of the many troubles about our present financial difficulties is the complexity of the intellectual issues involved. To the superficial observer, at least, the crisis of last autumn blew up in a comparatively clear sky: how many professional prophets predicted anything like what actually happened? Moreover, even if, with wisdom after the event, we piece together the various influences immediately operative, how much agreement do we find concerning the longer-run tendencies operative? Was the inflation of the demand-pull or the cost-push variety? To what extent is the trouble to be attributed to the deficiencies of monetary policy as an instrument or is it true to say that the instrument had not been appropriately applied? These and such-like questions beset any attempt at diagnosis of the crisis.

When we turn to prescription, the position is no less complicated. Was a seven per cent. Bank Rate justified as a crisis measure or was it simply the last resort of a conventional misapprehension of the situation? Is a ceiling on advances an appropriate control of the volume of money? Was there no alternative to cuts in investment? How are all these measures to be conceived in relation to developments in the outside world? And in any case where do we go from here? Is inflation really an evil and, if so, how far are we prepared to go to stop it? Is a centrally controlled wages policy an appropriate remedy? What should be our attitude to the question of the reserve? It is to problems of this sort that we need at least a provisional answer before we can make up our minds on even the smaller issues of day-to-day policy. Small wonder that at the present time there is more confusion, more division among men of knowledge and goodwill than perhaps at any time in post-war history.

It is not my belief that I know all the right answers to these tremendous questions. Anyone who has participated continuously in public discussion of such matters over any long period of time—in my case, more than twenty-five years—must, if he is candid, admit to many occasions on which he has made

mistakes and the strong probability that he may make other mistakes in the future. We are all in the same boat in this respect. But if we are to make any progress at all we must go on exchanging opinions and seeking to set forth, with mutual respect and toleration of other points of view—commodities in somewhat short supply in certain quarters recently—the ultimate reasons for our own attitudes. At any rate, it is in the hope that in this way we may eventually come to greater agreement that I venture to offer these very fragmentary and very imperfect reflections.

II

THE CAUSES OF THE CRISIS

Let me begin with the immediate causes of the crisis.

The first point which deserves to be made is a negative one: this was *not* a crisis of the current account. Despite the embarrassments of the ill-conceived Suez adventure, in the first half year we were running a surplus on balance of payments account at the rate of £250 millions per annum; and the indications are that for the full year the surplus was probably of the order of £200 millions. The belief that it was the trade figures which were to blame was ill-founded. It is true that a surplus of £200 millions per annum is not all that might be wished. If we are to play our part in overseas development and, at the same time, achieve a reinforcement of the reserves commensurate with our external obligations, something more like £450 to £500 millions is desirable. Still, the fact that it fell short of the ideal does not turn a quite respectable surplus into an alarming deficit. The true causes of the trouble have to be looked for in quite a different direction.

There can be no doubt that for some time prior to the crisis the position of sterling in the foreign exchange markets had been under some suspicion and the holders of sterling had been apt to be apprehensive of the slightest adverse movement. It is probable, however, that the immediate occasion for the beginning of the run was the partial devaluation of the franc which, perhaps because it was only partial, inevitably gave rise to expectations of further changes. There were rumours of an upward revaluation of the mark and all sorts of vague talk of a general realignment of European currencies.

In such circumstances it was only to be expected that sterling should come under pressure. There was no likelihood

that sterling would appreciate in any such realignment and some possibility, to put it mildly, that it would depreciate in terms of the stronger currencies, the mark and the Swiss franc. Now, whatever may be the moral obligations of British nationals when confronting such prospects, there is obviously no obligation on foreigners to expose their funds to loss or to forgo the opportunity of gain. Some movement out of sterling was, therefore, almost inevitable.

In the general position of London ever since the war, such movements tend to have a snowball tendency. The reserves are so small in relation to our external liabilities that, if there is a significant downward movement, all sorts of holders, who would not normally have wished to move, begin to think that perhaps it would be better to get out before things get very much worse. This mood tends to spread. Creditors, who have payments due to them in sterling, withdraw their money earlier than would otherwise have been the case. Debtors, who have payments to make, defer payment as long as they can in the hope that it will cost them less in the end. Pure speculation begins to play its part and extensive bear positions are created. If the reserves were larger, the danger of this kind of development would be to that extent less. With a really adequate reserve, the capital account could sustain substantial withdrawals without the danger of a run.

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But, even with the reserves at such a low level as ours since the war, the situation is not necessarily unmanageable. There is room for much difference of opinion concerning the policies adopted last autumn. But one thing surely has been demonstrated: that a run of the kind which was taking place can be stopped, if sufficiently strong action be taken. And if action is taken sufficiently soon, and if there exists a general expectation that it will be carried to any lengths requisite to reverse the drain, then, as likely as not, very severe action will not be necessary. This is not a universal rule. It is not difficult to think of external drains which could not be dealt with in this manner. But in general it is true that, where there exists general confidence in the determination of the authorities concerned to adopt the policies necessary to safeguard whatever reserve there is, then a cumulative deterioration of the situation is unlikely.

This takes us to the very heart of the trouble last year.

Rightly or wrongly, there was no confidence. There was no confidence in the willingness of the financial authorities to take action to safeguard the reserve. And, more fundamentally, there was no confidence in the willingness of the government to pursue policies which would mean that the reserve was not continually in danger. As we have seen already, it was not true that the current account was in any immediate danger. But it was true that it was feared very generally that policies were dominant which would bring just this danger about. The failure to restore a position which had begun to deteriorate two years earlier, the continuation of inflation and the prospect of rising levels of public expenditure, all contrived to produce an expectation of further deterioration. And when such expectations are prevalent they tend to bring their own realization.

Thus, while the immediate occasion of our troubles last autumn was provided by external events not within our immediate control, the cause of their magnification and the apparent unmanageability of the situation was a general belief in the weakness of our own internal policy. It would certainly be wrong to argue that, if there had been no internal weakness, there would have been no alarms and excursions regarding France and Germany. But if the internal position had been strong, these alarms and excursions would have been very much easier to deal with. And the root cause of our weakness, of our failure to accumulate a sufficient reserve and to achieve a position in international trade strong enough to be immune to the impact of international rumour, was the continuation of internal inflation.

It is, therefore, to the examination of this situation that we must now turn.

III

THE CAUSES OF INFLATION

Let us begin by reminding ourselves of what had actually happened. If 1950 be taken as 100, by the autumn of 1957 the cost of living index had risen to 143. This shows an average rise of nearly 6½ per cent. per annum. During the same period in Germany, prices rose to 115, or by 2·2 per cent. per annum, and in the United States to 118, or by 2·7 per cent. per annum. Nor was there any pronounced tendency for this movement to cease. Since early in 1955 various measures of restraint,

including a credit squeeze of sorts, had been in operation. Yet in the twelve months from August, 1956, to August, 1957, the rise in prices was still as much as 4 per cent. The fact that, with a rate of inflation so substantially higher than in the two other great industrial countries mentioned, our balance of payments was not in a much poorer condition, must indicate a very considerable degree of under-valuation in 1949 when the sterling parity was altered. But, obviously, such elbow room has its limits. It was not unreasonable, therefore, for both foreign speculators and observers nearer home to feel that, if the inflation continued in this manner (i.e. at a greater rate than elsewhere), then there was grave trouble ahead.

What was the prime cause of this tendency? Did it arise on the side of demand or on the side of costs? If it was a demand inflation, the operative factors were an urge to business expansion born of the prospect of good profits, a situation in which liquid funds were plentifully available to business, either in their own reserves or in capital markets where the terms of borrowing were very much lower than the prospects of profits. If, on the other hand, the upward pressure on prices is conceived to have originated on the side of costs, the significant factors in the situation would have been a continued pressure of the trade unions to better their relative position, and it would have been a continued rise in wage-rates which, in spite of apprehensions of diminished profits, compelled producers continually to raise their prices. Clearly, both explanations are conceivable. The question is, which fits the facts?

From my point of view, for the greater part of the post-war period it is the explanation in terms of the pull of demand which has the greater plausibility. If the prime movement had been on the side of costs, the prospect of profits would have been continually threatened, the index of wage-rates would have tended to rise faster than the index of weekly wage earnings, the volume of vacancies would have tended to fall below the level of applications. And these things did not happen. For the greater part of the time, profit prospects were good, earnings were rising faster than wage-rates, and the volume of vacancies remained higher than the volume of applications. As I see the picture, the rise of wage-rates was, for the most part, the *consequence* rather than the *cause* of the situation. The demand for labour was so strong that, even if the trade unions had been much weaker, it is probable that a similar movement would have taken place. Indeed, paradoxically enough, it might have

been more accentuated: the cumbersome process of collective bargaining tends to take longer than the operations of freer markets.

Towards the end of the period and at the present time the picture tends to change. It is probably true to say that, when you put the brake on a demand inflation you are then confronted with the danger of a cost inflation. If the trade unions have got into the habit of cashing in on the demand inflation every spring, then very naturally they will tend to go on trying to do so for a time even though the increase of demand has slackened. They will continue to press for increased wage-rates; and now, if inflation proceeds, it can be described as having its origin on the side of costs.

This explanation also seems to me to fit the facts of recent history. The penultimate phase of the U.K. inflation begins in 1954 with the lowering of discount rates and various budgetary easements, notably the change in investment allowances. An investment boom of full dimensions develops. Then in 1955 sundry checks begin to be applied, the first credit squeeze, the autumn budget and so on; and the prospects of profit, although still pretty good, become less attractive, the disparity between the rise of earnings and wage-rates begins to diminish, the gap between vacancies and applications narrows . . . Inflation from the pull of demand tends to diminish. Inflation from the push of costs becomes more likely.

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All this is obviously very controversial: there are many observers of the situation, whose judgement I respect, who would differ considerably in emphasis, giving more weight throughout to the push of costs, less to the pull of demand, than I find appropriate. But on one point I hope we should all be agreed; namely, that none of this could happen if there were a sufficiently strong control of the supply of money (i.e. cash plus bank deposits). By this I do not wish to beg the question whether such a control is itself desirable—there will be much more to say about that later on. Nor do I argue in the least that the supply of money is the *only* factor governing the volume of expenditure: it is almost humiliating at this time of day to have to insist that any form of the quantity theory held by any reputable economist in the last two hundred years has taken account of the demand for money (expressing itself *via* velocity) as well as of the supply thereof. All that is contended is that, if the supply of

money is adequately varied, the other influences on expenditure can be offset so as to prevent inflation.

But if this is so, how did it come about that in all these years the inflation was allowed to continue? It cannot be argued, at any rate since the return of the Conservative government in 1951, that the authorities were opposed to the use of monetary policy *per se*. In the early years after the war, under the Labour government, this may have been so: at any rate a positive monetary policy was not pursued. But since 1951 all that was supposed to have been changed: the return to monetary policy was claimed as one of the positive achievements of the change of régime. And, in the first crisis of that period, monetary policy had indeed some effect. Yet inflation reasserted itself: and when, since the summer of 1955, there was some show of control by way of monetary policy, the results, at least until the drastic measures of last autumn, were not all that might have been wished. It would be going much too far to say that the credit squeeze and the other monetary measures which accompanied it had *no* effect—a case could be made out for the view that by the winter of 1956–7 they were beginning to work. But it is quite obvious that up to last autumn they had not stopped the inflation.

At least three reasons can be given for these disappointing developments.

In the first place, come the deficiencies of fiscal policy. The budgets of 1954 and 1955, with their changes in investment allowances and tax reductions, definitely tended to an increase of general expenditure. And thenceforward, until the Thorneycroft budget of 1957, it must be noted that very little was done to bring the surplus above the line into a non-inflationary relation with the below-the-line deficit.

Now, monetary policy, properly conceived and executed, can be a very powerful means of stopping an inflation. But if fiscal policy is tending the other way, then the strain put upon monetary policy is to that extent greater: even tighter conditions are required. And that, clearly, was one of the governing circumstances. With their fiscal measures—or lack of measures—successive Chancellors tended to undo what they were trying to do with the discount rate and credit policy generally. It is easy enough to understand and indeed to sympathize with the motives. The long-run arguments in favour of reduction of some taxes are very strong indeed. But reductions of taxation, unless accompanied by reductions of expenditure or by the

substitution of other taxes, are apt to have an inflationary influence. And this is one of the things which has been happening since 1954.

Secondly, given the task to be accomplished, then, even on the assumption that the machine was in good working order—an assumption to be questioned in a moment—it seems clear to me that what monetary measures were adopted were both too little and too late. The theory of monetary policy does not say that *any* raising of interest rates, *any* tightening of the credit base, is sufficient to curb over-all expenditure, however strongly it is developing: it says that *some* level of interest rates, *some* curtailment of the credit basis may be relied upon to have that effect. And what these critical levels are varies obviously with the general tendencies of the system, and the time of the operation. A small touch on the brakes at an early stage may be more effective than greater pressure later on. If there is an over-all budgetary deficit, then the optimal level of interest rates will be higher than if there were an over-all budget surplus.

But here too the evolution of policy was the reverse of what was required. At the time of the budgetary easements in 1954, interest rates had recently been lowered. Throughout the ensuing months, as the inflation gathered strength, monetary policy was further eased. Then, when rates were eventually moved up, the movement was so small that, even if the machine had been working properly, it would have been very surprising if it had been effective. At each stage, when change came it seemed to be wrung out of the authorities long after outside opinion had formed the conclusion that it was necessary. Clearly, this is a matter on which there can be much argument in detail. But I do not think it unfair to say that, until the autumn of last year, nothing that was done in this sphere gave the impression that it was likely to succeed.

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All this, I suspect, would be true even if, as I have assumed hitherto, the machinery of control had been working as it is supposed to work in the standard textbooks—if, that is to say, the Bank of England, through its discount rate and its open market operations, had had effective control of the volume of credit. This brings us to the third reason for failure.

For, in fact, it is now pretty clear that the control was no longer working according to the standard model. It has been

demonstrated by Professor Sayers[1] and by the editor of this journal[2] that the immense volume of floating debt now outstanding introduces a complication into the situation which is not dealt with in the textbooks. To all intents and purposes the Treasury bill has become the equivalent of money: and, with the Treasury bill issue in other hands, the control of the credit base by the central bank is necessarily weakened. The application of the lever no longer automatically applies the brake. A detailed explanation of the events of recent years in these terms is still a matter of considerable obscurity: only the Bank of England is in full possession of the necessary information—and that information has never yet been made public. But, speaking broadly, it is clear enough that in recent years there have been times when, because of government borrowings on short term, the Bank has no longer been in a position to control the situation. At a time when too exclusive a reliance was being placed upon monetary policy, the apparatus thereof was defective. The braking mechanism, so to speak, was in continual danger of failing to grip. And on several occasions it did fail.

But this brings us to the events of last autumn.

IV

THE NATURE OF THE CRISIS

Memories tend to fade of events which were unpleasant. To see what happened in proper perspective it is desirable to remind ourselves of the situation with which we were confronted.

The central fact of this situation was the drain of reserves. For many weeks before September 19th, gold and dollars had been pouring out of the country at a rate rising to £100,000,000 a month. At the lowest point of the crisis the reserve had fallen to $1,850 millions. That is to say, at the then rate of withdrawal, there would have been a total exhaustion within a matter of months. But, of course, long before this, as the process proceeded, the rate would have increased: there would have developed a veritable *sauve qui peut*. The plain fact was that, if nothing had been done, either devaluation or a repudiation of current obligations was a virtual certainty within a few weeks.

Now, it is a matter of fairly general agreement that, if

[1] *Central Banking after Bagehot*, pp. 92–107. "The Determination of the Volume of Bank Deposits: England 1955–6."

[2] *Lloyds Bank Review*, April, 1956, pp. 24–38. "The Floating Debt Problem."

there is what the Bretton Woods statutes call a "fundamental disequilibrium" in the external relations of a financial centre, then devaluation may be an appropriate remedy. If prices and costs in any area have got so out of line with prices and costs elsewhere that, to restore equilibrium at fixed rates of exchange, a general deflation of local rates of pay would be necessary, then it is better to alter the rates of exchange. This is true whether the disequilibrium is due to deflation elsewhere or to inflation at home. If deflation elsewhere is the cause, there is not much occasion for argument: there is no reason to import deflation. But the same is true if domestic inflation has been the culprit. Inflation of this sort is an evil: but so too is deflation. Rather than endure the damages of long drawn-out unemployment and loss of production, better operate on the foreign exchanges.

But the crisis last autumn was not a crisis of this nature. As we have seen already, it was not a crisis on the current account. It was the capital account which was in difficulties. And here the trouble was due to a fear of devaluation or a fear that further inflation would upset the current account and so make devaluation necessary.

In such circumstances it would probably be more or less generally agreed that devaluation would have been totally inappropriate. It would have robbed our creditors. It would have made our imports more expensive. It would have strengthened the tendencies to internal inflation. It was, therefore, entirely inadvisable as a voluntary policy; and to have sat still doing nothing and watching devaluation forced upon us would have been an abject failure of government.

For similar reasons, I cannot believe that on this occasion any good purpose could have been served by letting the rate float. The policy of the floating rate is an acutely controversial matter and it would be idle to claim that there is any general consensus of opinion about it. But I think that it would be generally agreed that a moment of extreme weakness is not the moment for making such an experiment. The rate would certainly have plunged downwards, precipitating further withdrawals and, in the absence of countervailing measures, provoking further internal inflation, eventually justifying a permanently lower rate—the so-called ratchet effect. Although in general I prefer the system of fixed rates with the possibility of agreed adjustment à la Bretton Woods, I would not rule out the use of the floating rate on any possible occasion: a depression of the

1929 intensity in the U.S. might well create a situation in which for a time it was advisable to let the rate take the strain. But the situation in September last year was not at all like this and, in my judgement, a floating rate would only have made things worse.

As for the repudiation of current obligations which would have been involved by the re-imposition of full exchange control and the blocking of the sterling balances, surely it would have been both dishonourable and inexpedient. It would have been dishonourable since these balances have been left here on the definite understanding that they would be available whenever required. In the years immediately after the war there was a case, which I, for one, thought very cogent, for imposing some restraint on the release of the abnormal accumulations of war-time. But that is ancient history: for the most part, the war-time balances have been run down; the present balances have been deposited since then. To close down on them without putting up a fight would be the most flagrant failure to keep faith with our clients. It would be inexpedient too: whatever we may think of the eventual future of the sterling area, whether we foresee for it a glorious future or whether we think it will eventually give way to other arrangements, we surely do not wish to see it liquidated overnight with all that that would imply. But that is what the blocking of balances and the reimposition of all-over exchange control would involve.

But if all these courses were rejected, what remained? In my judgement, at least, the course which was actually adopted: a clear announcement that the rate of exchange was not to be changed, backed up by the announcement of measures which should prove unmistakably to the world at large that the inflation was not to be allowed to continue.

The formula is simple enough. But there can be no doubt that its application involved greater hazards than would have been present earlier on. It is safe to say that, up to last summer, at almost any time in the preceding six years, the government could have stopped the inflation without running any risks that really mattered. To stop a small local inflation when the rest of the world economy is running at a high level involves no danger of subsequent deflation. But again and again we refused to grasp the nettle. With an unemployment percentage continually lower than anything recorded in peace-time history, we let fears of totally imaginary dangers inhibit the very mild

measures that would have been necessary. But now the position was beginning to change. A recession was developing in the United States. Should we not be imposing our anti-inflationary measures at a time when there was at least a risk that anti-deflationary measures would become necessary a little later on?

As I see things, the danger was—and is—a real one. The possibility of a deepening of the U.S. recession was not imaginary. But neither was the possibility of a total collapse of sterling. And the one danger was certain and near at hand, while the other was still remote and conjectural. Moreover, it is difficult to believe that, if our crisis had been allowed to intensify with an eventual immobilization of the reserves and free funds of the sterling area, there would have been any substantial alleviation of the troubles of the world at large—quite the contrary indeed. Hence the commonsense maxim of dealing with dangers one at a time as they materialized was still applicable. The order of the day was to save the pound. If there was a world depression by next summer and the pound had been saved, perhaps we could do something to help. But if the pound had collapsed and London was immobilized in the splints and bandages of a post-crisis exchange control, that would be out of the question. In such circumstances, to refuse to stop our own inflation because later on deflation might come elsewhere would seem to be about as sensible as refusing, when the house is on fire, to call the fire engine on the ground that there may be floods later on.

V

THE POLICIES OF THE EMERGENCY

Now for a few brief comments on the measures actually adopted—the raising of the Bank Rate and the limitations on advances and expenditure. I will also add a word on the absence of any further limitations on consumption.

(a) The Raising of the Bank Rate

To begin with the Bank Rate. From my point of view the surprising thing about this episode is, not that it happened but rather that so many people were surprised that it happened—and among these, not merely everyday citizens, to whom the proceedings of a great capital market are perhaps inevitably always something of a mystery, but also professional dealers whose livelihood depends upon an intelligent understanding of these matters. I am sure that an observer from Mars who, before,

his visit, had worked up his knowledge of mundane financial crises by a short study of how the majority of central banks have behaved in the majority of past financial crises, would not have been at all surprised. Yet here were people who had been in the business all their lives to whom the bare possibility does not seem ever to have occurred. No wonder they were a little upset.

Now, it may be admitted at once that the effectiveness of movements of the Bank Rate as a sole means for controlling the total volume of expenditure may very justly be called in question. It is certainly arguable, as I have argued above, that the powers of the Bank in our own time have been gravely impaired by a distended volume of short-term government debt: and that, for that reason, an effective control of the money supply demands more drastic and comprehensive measures. There will be a good deal to say about this later on.

But this is not to say that as a crisis measure, a raising of the Bank Rate is to be regarded as ineffective. It is, of course, not true that such a movement, carrying with it, as it does, a corresponding movement of conventional rates on borrowing and lending, not to mention strong psychological effects on the security markets, has *no* effect on the volume of internal expenditure—even though it be arguable that such effects can be as well produced by other, less expensive means. And, internal effects apart, it would surely be quite absurd to argue that it has no effect on the movement of funds into and out of the country. It has a direct effect *via* the cash incentive: it increases the advantages of leaving money here or bringing it in, it diminishes the relative attraction of other places. The indirect effect is even more important: it is a signal to all and sundry that the integrity of the currency is to be preserved. Whatever the deficiencies of our present machinery, it is an important fact that the members of other financial centres tend to regard the movement of money rates as an index of policy. To them the raising of the Bank Rate here is a sign that the pound is to be defended.

I wonder how many of those who have been most critical since this measure was taken in fact would have been prepared at such a moment to forgo these advantages. With gold and dollars pouring out at catastrophic rates, would it not have been just a trifle purist to have abstained from the use of an instrument which again and again in the past had been proved to have the effect of arresting this kind of drain? I do not think

many of the critics would have wanted to devalue. Some, perhaps, would have argued for complete exchange control, though it is doubtful if at the same time they would have welcomed the consequences of such a régime—a complete break-up of the sterling area. But, if such expedients were not acceptable, it is not easy to see any practical alternative to what was actually done. Or is it to be argued that the drain would have come to an end of its own accord—as the result of speeches by ministers assuring the world at large that in fact everything in the garden was lovely?

(b) **The Limitation on Advances**

If this argument is correct, Bank Rate is still an indispensable weapon for dealing with an acute crisis. For dealing with a secular tendency to inflation, however, it is not a particularly suitable instrument. For this purpose it is desirable to adopt other measures for limiting the flow of expenditure.

So far as the banking system was concerned, the measure which was actually adopted was the imposition of an upper limit on the aggregate of advances. Each of the clearing banks undertook not to exceed in the present twelve months the average level of its advances in the preceding year. There were small modifications of detail for particular lines of credit. But this in substance was the broad policy adopted.

Now, conceived as a crisis measure, to be adopted at short notice with the minimum of resistance from all immediately concerned, there is probably a good deal to be said for this device. It has precedents in past policies. It requires no legislation or statutory regulations. And, despite the strictures which I shall develop shortly, it cannot be said to be without effect; there would not be so much grumbling if this were in fact the case.

Nevertheless, conceived as a policy for the longer period, still more if conceived as an expedient to be adopted whenever this kind of danger emerges, it is open to considerable criticism. It bears unequally upon different banks, according to the different lending policies which they have been pursuing. It tends to paralyse financial competition, which in the long run must be a very bad thing. And, as a partial control, it does not really go to the root of the matter. The root of the matter is control of expenditure as a whole.

But to do this the fundamental *desideratum* is control of the supply of money. Given over-all control at that end, there

can be adaptation to all sorts of vagaries of expenditure in particular sectors. Given an absence of such control, there can be no guarantee that control in one sector will not be frustrated by the absence of control elsewhere. This is not to say that, even if the supply of money is under control, there may not arise a need for supplementary special controls. But it is to say that, if it is not under control, the whole system is liable to get out of hand.

Now, as already emphasized, the disquieting feature of the recent situation was that the money supply was not under effective control: the excessive volume of short-term debt has weakened the hand of the central bank. The monetization of debt has made the Treasury rather than the Bank of England the arbiter of the total volume of cash plus deposits. The needs of short-term borrowing rather than the needs of the system for cash and credit have been liable to disturb over-all stability.

In more normal circumstances the appropriate remedy for such a situation would be funding. The volume of Treasury bills should be reduced until there is no threat to the complete control of the credit base by the Bank of England. It is true that this would involve some increase in the annual debt charge. But to keep this charge down by techniques which endanger the future of the pound is not sensible policy. An increase would be a small price to pay to regain control of the credit base and hence of aggregate demand in general.

Unfortunately, in a financial crisis such operations are not necessarily practicable. Throughout the greater part of the year the position had been becoming more difficult in this respect. After years of passive acquiescence in lending in a deteriorating standard of value, the investor had gradually become aware of what was happening and was demanding progressively higher returns on fixed interest securities. The Church of England and the learned societies had led the way; and now the man in the street had tumbled to the fact that if you lend for a money return of 4 per cent. per annum net and the value of money is falling at the same rate, then you are lending at a zero rate of interest. The run on the pound intensified the difficulty. It is safe to say that, in August and September of last year, orthodox funding on a scale necessary to re-establish control of the credit base would have been quite out of the question.

In such an emergency there seems to me strong argument for some extraordinary measure which, by operating on the liquidity position of the banking system shall impose limits on

its total lending. If action can be taken at this end, then there need be no paralysis of competition, no wooden interference with different modes of doing business. But the credit base as a whole can be brought under effective control.

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In public discussion, the device most favoured for accomplishing this has been compulsory variation of minimum liquidity ratios. On the assumption that, in modern conditions, it is the liquidity position, rather than the cash reserve, which ultimately governs the supply of money, it is argued that powers should be taken to require the observance of minimum liquidity ratios and that these ratios should be varied according to the requirements of general policy. This is not the same as the existing provision of the banking law in the U.S. under which the Federal Reserve Board has the power to vary minimum cash reserve requirements; although it has sometimes been mistaken for this, it is a more comprehensive requirement. But it is a device of the same type conceived in relation to the exigencies of our own system.

In principle, there seems little objection to such a regulation provided it is regarded as an emergency expedient. But there are technical difficulties which are often overlooked. The actual liquidity position of the banks varies from week to week; and, since the effects on investments and advances of such changes are multiple, it would be necessary to make very frequent changes in the prescribed ratio. Moreover, these changes would have to be by small fractions, not easy to judge and not easy to justify to the public.

Much superior in my judgement is the plan which was recommended as far back as August, 1956, by Messrs. Paish and Alford[1] and again by Messrs. Alford and Edey as the crisis was developing[2], namely, the imposition of a fixed liquidity ratio—or one varied at comparatively long intervals—plus a revival, for the duration of the crisis, of the system of Treasury Deposit Receipts (T.D.Rs.) whereby the banks are required from week to week to keep an appropriately varying volume of assets in a form which is definitely illiquid. Such a method is capable of doing all that is claimed for the system of variable liquidity ratios but with much greater refinement and precision. The appropriate variations in the supply of money are now

[1] "How Interest Rates cut Spending", *The Banker*, Vol. LVI, No. 367, pp. 476–487.

[2] *London and Cambridge Economic Bulletin*, September, 1957.

secured *via* the variations in the volume of T.D.Rs. rather than the variation of the liquidity ratio. The principle of the operation is the same.

Let me hasten to add that, in my judgement, in being regimented in this manner the banks would have a real grievance. Their business would be being interfered with because of a situation created not by their policy but by the policy, or rather lack of policy, of the government. But I do not believe that this kind of interference would be more damaging to their business than the interference to which they are now subjected under the present arrangements of the credit squeeze: and if there were some definite understanding that the regulation was to be regarded definitely as transitory, to be relinquished as soon as orthodox funding on an adequate scale was once more practicable, I do not think that the grievance would be intolerable.

It may well be that the occasion for this sort of thing is even now passing. As the prospect of inflation wanes, the possibilities of orthodox funding become more extensive. Nevertheless, it seems to me that there is perhaps some utility in thus spelling out the principles of alternative measures even if on this occasion they prove to be no longer applicable.

(c) **The Limitations on Expenditure**

Finally, we may note the proposed limitations on expenditure.

This is so political a subject that it is not easy to say much about it that is not right outside the sphere of economics in any sense whatever. How much the country will stand in the shape of reduction here, what it would be prudent politically to exempt there, to what extent discredit will arise if a gesture is not made in this direction—these are not questions on which the economist who does not care to transform himself into Adam Smith's "crafty and insidious animal", the politician, has very much to say. Two comments, however, are perhaps permissible.

The first is that, in the context of what was actually proposed, the term reduction is misleading. The celebrated "cuts" were prospective. Extra expenditure which had been projected was to be forgone. Doubtless, this was very important. Increases on the scale which had been contemplated would have imposed still more strain on the system; and we must not underestimate the political effort apparently necessary to impose even this degree of restraint. Nevertheless, if we are to use words

accurately, not *reduction* but *standstill* was the more appropriate description.

The second comment is that, in the subsequent discussion, the nature of the margin for manoeuvre has been often misconceived. To judge from leading articles and correspondence in the press, it would appear that there were immense savings available if only ministers would order a naturally spendthrift and wasteful public service to be more careful all round. But this is a pathetic and dangerous delusion. Doubtless there is always a little waste even in the best regulated establishments; and perhaps there are a few hundred thousands to be gained by general cheese-paring on small items which are unable to defend themselves and which, on intrinsic merits, perhaps even deserve some increase. But all the main reductions possible involve, not administrative, but political decisions, and major decisions at that; and decisions on matters of this sort are the decisions which most ministers of most parties tend to shirk. Perhaps they are right. Perhaps some wisdom, invisible to those not in the fray, prevents them from steps which would disintegrate, not only their own peace of mind, but also the fabric of society. But if this is so, then standstill, or a slower creep forward, is the most we can hope for in the sphere of public expenditure; and in respect of what has been done recently we should be grateful for small mercies.

(d) The Absence of Limitations on Consumption

The criticism is sometimes made of the measures adopted last autumn that their main incidence fell almost wholly on investment. The raising of the Bank Rate, the ceiling on advances and the "cuts" in public expenditure all tended to have their main effect, directly at least, by restraints on the volume of investment.

The immediate answer to this, I suppose, is that, in an inflationary situation, the cutting of investment is the cutting of investment for which no corresponding savings were planned. If the disposition to save had been adequate, then there would have been no danger of inflation.

Nevertheless, in a situation in which so much is artificial, I see no particular reason to believe that the existing volume of savings is, in any sense, optimal; and I see no objection in principle to applying restraints on consumption in order to ease inflationary pressure. If, in such a situation, there were available tax variations which, without damaging the incentive

to work or to save, could have restrained pressure at the consumption end, then in my judgement there would be good ground for imposing them.

The trouble is to discover appropriate and practical methods—particularly when the crisis blows up in an inter-budgetary period. I confess that I see no good grounds for still further variations in a purchase tax system which is already sufficiently arbitrary and discriminatory. If there existed a general sales tax in its place—still more, if there existed a general sales tax *plus* general exemption allowance[1] such as has been proposed by Professor Paish—I would say that the circumstances of last autumn provided a copy-book case for the use of variations both of the rate and the exemption allowance, as counter-inflationary influences. Unfortunately, such expedients do not exist and it is not possible to improvise them overnight.

Equally efficacious, and perhaps politically no more difficult to impose, would be variations in the contributions of employers and employed to the social insurance funds. This plan, invented by Professor Meade, was blessed by both parties in the Coalition White Paper on Employment Policy. After the war, the essential machinery was actually built into social insurance legislation by the Labour government; and there can be no doubt in principle that comparatively small variations here could have powerful countervailing influence either against inflation or deflation. Unfortunately, the machinery was never used by those who installed it; and probably at the present time, there is a good deal of political and administrative dust in the works. I still think, however, that it is a very good plan and that on some future occasion it should be tried—either one way or the other.

VI

PROBLEMS OF THE FUTURE

And now what? There can be no question that, whether or not they were the best that could be conceived, the measures actually adopted last autumn have stopped the run. Since September 19th the reserves have been mounting again—not perhaps quite as rapidly as might have been hoped, but nevertheless unmistakably and strongly upward. There have been various signs that confidence is not completely re-established—

[1] To be effected by a distribution of coupons entitling each citizen to a certain volume of tax-free purchases.

the downward flicker following the very hostile reception of the Cohen Report, for instance—and the prospect of divided counsels and political dissension in the future gives rise to legitimate apprehension. But, for the moment, the atmosphere of crisis has passed and we can look round a little.

The first question which naturally arises is how we now stand in relation to developments in America. Has the contraction there reached a point which is so liable to infect us with similar tendencies as to warrant a complete reversal of policy here? Are we confronted with a major depression in the world at large against which it is a prime necessity for us to take independent internal action?

The enquiry is serious; and, as I have indicated already, I think that it deserves to be taken seriously. I should, therefore, like to make it quite clear that it is my view that if the contraction in the U.S. were to assume the dimensions of a major depression, it would be incumbent upon us to adopt insulating measures. I do not think that this would be at all easy; it is quite possible that present rates of exchange would have to be sacrificed in the process. But it seems to me plain that, in the event of such a development, such policies would be necessary.

If, however, this does not happen, if the American contraction is arrested before it goes into something really severe, then I think any attempt on our part to take the initiative would not only be premature but also dangerous. The pound is certainly not yet strong enough to risk the impression of a renewal of inflation. Anything which tended now to raise our prices and costs while the rest of the world was consolidating at a lower level would be a renewed embarrassment. And from the point of view of the world at large, we should certainly do no one a good service by a policy which once more threatened the position of sterling. Clearly, we must avoid unnecessary severity. The object of the present exercise is to strengthen the pound and prevent expenditure rising faster than productivity; and, as the danger to the capital account diminishes, there will be no need to prolong measures which were specifically suitable for dealing with that particular difficulty. But to go beyond such relaxations would be risky. This is very unfortunate. It would be very gratifying to be in a position in which we could afford to take the initiative in stimulating a world revival. But to be able to do that now we should have put our position in order earlier. With a strong reserve all sorts of things would have been possible that with a weak reserve are a source of peril.

Now, I do not profess to know what is going to happen in America. Where expert opinion on the spot is so sorely divided, it is surely to set a high value on one's powers as a prophet to pretend to predict from a distance. I confess I find it hard to believe that, in an election year with so many shots in the locker, the Administration and Congress will be content to witness a dangerous deterioration. But such things have happened before and I would not be sure. What seems to me to be fairly clear is that there have been no developments yet which, in our special and highly peculiar position, would call for extraordinary action. I hope myself that the U.S. Administration will redouble its efforts to put the gears in reverse: I wish, for our sake, that they had done so earlier. But I see no immediate call for such action here. The situation calls for unceasing vigilance, and if things get very much worse we may find ourselves the other side of the looking glass where all sorts of rules are reversed. But so far I do not think this has happened. For us at least—although not, I suspect for the U.S.—the maxims of prudence still have a positive sign.

* * *

Assuming this to be correct, let us enquire a little further concerning the nature of these maxims. Assuming that events elsewhere do not compel a drastic change, how should we wish our own development to proceed? What are the fundamental objectives of policy in regard to expenditure and the price level?

It should be clear in the first place that these objectives do *not* include deflation—policies designed to produce a positive contraction of incomes or the price level. It should not be necessary to labour this point. But I am afraid that experience proves that it is. It has become almost a habit, recently, among certain writers and speakers, that if a man argues against *in*flation, he should be at once denounced for recommending *de*flation. I suppose that, in most cases at least, one ought to treat this as if it were sincere: the subject is difficult and tempers are easily aroused. But deflation is certainly not the only alternative to inflation. It is perfectly possible—and until recently I should have thought that it would have been assumed to be the most natural attitude—to be opposed to both and to regard some sort of over-all stability as the objective. At any rate, despite popular oratory, I have yet to meet any responsible person who wishes to impose a positive deflation. To stop inflation, that is the objective: and to talk of deflation and mass unemployment, when the cost of living index has only just stopped rising and the

unemployment percentage is still lower than in most other countries of the world and at most times in modern history, is simply to darken counsel.

But do we really want to stop inflation? I suppose there are very few politicians who would admit to wanting it to continue. But a great many act as if they were prepared to tolerate such an outcome; and there are certainly others, not so directly connected with politics, who are definitely prepared to argue as if it were something which we ought to put up with. In modern conditions, it is contended, while of course hyper-inflation is to be avoided, a creeping inflation is to be accepted as the condition most conducive to growth. To make stable money the objective is to risk stagnation and unemployment.

I find this position unacceptable. I do not in the least deny that the process of *stopping* an inflation may involve some temporary check to production and employment: if you are swerving towards a precipice, some temporary slowing up is the price you have to pay for re-establishing a safer direction of motion. But I know no reason which would lead to the conclusion that smart rates of growth and high levels of employment are impossible on a steady price level. In the recent history of Germany, for instance, there is ample evidence disproving this view.

But suppose there are strong trade unions and an incessant pressure for wages rising faster than productivity, is not this expectation vitiated? Do there not then exist conditions in which growth can be sustained only at the expense of some degree of inflation?

The question is grave and so is the answer. If, for any long period, wages rise faster than productivity, then the alternatives are either unemployment and diminished production or continuous inflation. It is, of course, possible to conceive that some small increases of wages can be financed out of profits without serious reactions on employment. But the statistical limits are small; and it is to treat the subject with less seriousness than it deserves to assume that there is any long-lasting solution in this direction. Exactly the same problem would exist were all industry nationalized and all profits appropriated by the State: if wage-rates rose faster than productivity, the main alternatives would be unemployment or inflation.

But are we right in assuming that such a development is inevitable? I see no ground for a pessimism as deep as this. As I have argued above, I do not believe that the greater part of the

inflation which has taken place already is to be explained in these terms. On my conception, up to recently the rise of wages has usually been the *result*, not the *cause*, of the general inflation. When the demand for labour in most parts of the economy so much exceeded the supply, the trade union leaders would have had to be angels not to cash in on the situation. If they had not been there, it is improbable that the rise would have been much less.

But now the situation has changed. For the time being, at least, the demand inflation is at an end. The funds out of which it was financed are under more control—at least, let us hope they are. And the question what in the new conditions will be the policy of the leaders of the unions is not yet solved. I am not one of those who believe that much good is to be expected from mere exhortation to any section of the community; if I had been a trade union leader during the last few years I should have become positively neurotic at the barrage of appeals to my patriotism, social solidarity, sense of decency, and so on and so forth. But it is not at all obvious to me that trade union leaders are so indifferent to their own interest as to persist long in policies liable to create unemployment, if inflationary finance is not there. This is not to say that I should expect the ending of a period of inflation to be free of friction or that I believe that people in such positions are incapable of mistaking for a time where their true interests lie—the trade unions of this country for years have clung to restrictive practices which in the long run help no one. But it would surely be very short-sighted policy for any government to assume that such responsible bodies are incapable of learning from experience and to base policy upon the assumption that they will always react one way whatever the general state of the economy.

Whether this be true or not, my conception of the duty of governments in this connection is clear. It is not the duty of governments to make the maintenance of employment the be-all and end-all of policy, regardless of what happens to the value of money. It is their duty rather to maintain conditions which will make a high level of employment compatible with a stable value of money. They should not say we guarantee employment whatever demands are made in respect of wage-rates; they should say rather we will try to maintain such a volume of expenditure as, given an income-level rising with productivity, will maintain a high level of employment. If they do this, then, in a free society at any rate, it is for trade unionists and all the

rest of us to decide how we react as regards the prices we put on our own particular products.

This, clearly, is a controversial view. There are many who hold that salvation lies in a much more authoritarian direction. Control of wages from the centre, plus some measure of dividend limitation, is the solution they favour. My solution is in quite conscious opposition to this. I do not think that experience elsewhere suggests that in the absence of deliberate monetary stabilization, a general wage control is likely to be successful; and, if monetary stabilization is attempted, such a control seems to me unnecessary. I have no desire at this time of day to see the whole apparatus of independent trade unionism, which has performed such valuable services in the past, sacrificed in so dubious an enterprise. I think it is more compatible with the principles of a free society that we should be free to make mistakes and to learn from them than that we should be clamped down by a system of regulation from the centre which, if experience elsewhere is anything to go by, is itself no less liable to error.

* * *

To return, however, to the theory of continuing inflation, perhaps the ultimate criticism here is that the thing is extremely unlikely to work out as planned. I should be willing to concede that, *if* there could take place an inflation of, say, $\frac{1}{2}$ or even 1 per cent. per annum, and that *if* this could go on unperceived and unanticipated, then there might be important advantages. There would be a mild reinforcement of the power to accumulate in the shape of higher money earnings on the part of companies and employers. There would be elbow room for the process of collective bargaining to make small mistakes of rate-fixing without causing unemployment. Against this, there would be some injustice to the owners of fixed interest-bearing securities and the recipients of incomes which are only adjusted at long intervals. But experience of periods of mild gold inflation tends to suggest that on balance there would be substantial prosperity.

But all this depends upon the assumption that the process is unanticipated and, until it has happened, unperceived. If, after a time, people become alive to what is happening, still more if they come to assume that a certain decline in the value of money is one of the necessary concomitants of accepted policy, then they will adjust their plans accordingly and none of the

beneficial by-products of unperception will be present. Lenders will not lend, save for a higher rate of interest. Contracts will not be concluded, save with a margin allowing for the expected rate of depreciation. What is more, after a time, the difficulties will be cumulative. The fear of inflation tends to create more inflation. Most of the paper inflations of history were gradual to begin with: but they ended in something not at all gradual.

All this would apply to a community without external economic relations or where the external factor was relatively unimportant. Where, however, external relations loom large in the economic structure, as they do in ours, the effects of inflation are apt to be much more immediate and much more serious. If the inflation is not only absolute but relative, if, that is to say, it is greater than any such movement which is going on elsewhere, then the effects on the balance of payments show themselves very quickly. It is not a matter of danger in the long period, it is a matter of danger in a very few months. And this, of course, is particularly germane to our situation. I can imagine a mild inflation in the United States proceeding without overmuch difficulty for several, perhaps for many, years. I cannot conceive such a development in this country. If we go on inflating, and if our inflation is greater than is going on in important countries elsewhere, then—as indeed we know from the recurrent crises of the post-war period—the effect is likely to be sharp and sudden. And I do not think our peculiar system, with its world-wide ramifications depending essentially on a particular kind of understanding and confidence, can stand an indefinite succession of crises.

But that brings me to the last point which I wish to make in this already overlong paper. For the next few years at least, an objective, second only in importance to the avoidance of inflation or deflation, must be the strengthening of the reserve. With our capital account in its present condition, our reserves are quite inadequate. We are trying to be bankers for a large part of the world; but we are not prepared to keep a reserve large enough to preclude crises of confidence. In such conditions rumours which, were the reserves at all adequate, would exhaust themselves in light gossip, tend to start major convulsions. The position is not permanently viable: and it should be a major objective of policy to put it right.

It is sometimes said that this is impossible. We have done all we can since the war and yet there is no improvement. The only way in which the reserve position can be improved is by

some gigantic international operation. Failing this, we should set our sights at a lower target and resign ourselves to the mediocrity of our position.

This argument seems to me to lack substance. I am no foe to international action in regard to this problem; and I would greet with enthusiasm action of the kind suggested by Sir Oliver Franks in his recent annual statement. But I do not agree that, if international action is slow in developing, there is nothing that we can do to help ourselves. I cannot see any justification for this, either in theory or experience. Other countries have increased their reserves. Why should not we? What is so different in the condition of Germany and ourselves that while, on balance, our reserve has not increased at all since the summer of 1950, in the same period the German reserve has mounted from \$260 millions to some \$4,000 millions? Doubtless there are many inessential differences which can be cited one way or the other. But the main difference, I submit, is that the Germans have had the will to do this thing and we have not. And let no one say that this has been accomplished at the price of poverty and stagnation. Between 1950 and 1957, while our real output per head has increased by about 15 per cent., the German has risen by nearly 60 per cent.

Is it not the bankruptcy of statesmanship and national morale to argue that this sort of thing is impossible for us?

Lionel Robbins.

The London School of Economics.
7th March, 1958.

Ten Years of European Co-operation

By Eric Roll

I

TEN years ago, on the 16th April, 1948, representatives of 16 European countries and the Commanders-in-Chief of the Western Zones of occupation in Germany signed the Convention for European Economic Co-operation, and the O.E.E.C. was born. It is a striking testimony to the success of this institution that one cannot think or write of the economic history of Europe during the last decade (and of a great deal of the rest of the world as well), without frequently having to refer to the activities of the O.E.E.C., and, on many major issues, putting these activities in the centre of the account.

The Organization was conceived nearly a year earlier. In the late spring of 1947, in the United States no less than in Europe, the true measure of the economic consequences of the second world war was at last being fully realized. The improvement in industrial production which had been achieved in several European countries in the first post-war years was not maintained during the winter of 1946–7. Exceptionally severe weather, added to the underlying economic weakness, quickly created conditions of widespread food shortage, industrial stagnation and unemployment of the gravest kind. For the first time, what had been recognized by a few far-sighted men became generally accepted in Europe and the United States, namely, that the imbalance between the economic resources and potential of the Western Hemisphere and those of the rest of the world, symbolized in the dollar shortage, was deep-seated and persistent and had been only temporarily concealed by the final stages of Lend-Lease and by massive American loans.

With a foresight of which there are not many examples in history, a small group of officials in the U.S. State Department analysed this situation in May, 1947, and presented a clear statement of the policy issues arising from it to Mr. Marshall, the then Secretary of State. On the 5th June, Mr. Marshall made his historic speech at Harvard University. In it, he made

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The author, a member of the British Civil Service, was closely associated with the 1947 Marshall Plan Conference and with O.E.E.C. during its first five years as Chairman of the Programmes (later Economic) Committee. He was one of the "Four Wise Men" in the 1948 division of American aid.

it clear that Europe's requirements were such that she had to have substantial additional help if she was not to face economic, social and political deterioration of a very grave character. At the same time he stressed that it was not for the United States to draw up unilaterally a programme to put Europe on its feet. "The initiative must come from Europe"; and the rôle of the United States had to consist, first, in "friendly aid" in the drawing up of a European programme of recovery and, later, in supporting it. He invited Europe to prepare a joint programme which would show that the countries of Europe agreed among themselves "as to the requirements of the situation and the part those countries themselves will take in order to give proper effect to whatever action might be undertaken by this Government."

It was in response to this speech that Mr. Bevin and M. Bidault, after abortive negotiations for the participation of Russia and the Eastern European countries, called a conference which met in Paris on the 12th July. This conference set up a Committee of European Economic Co-operation, under the Chairmanship of Sir Oliver Franks, for the purpose of producing what Secretary Marshall had asked for: a joint European recovery programme. In less than 2½ months, by the 22nd September, 1947, the Committee had completed its task and had produced a report which, as an economic analysis and statement of policy, has remained unequalled in depth and scope to this day. In two volumes, the first a general review and declaration of policy, the second a detailed report of its four technical sub-committees on food and agriculture, iron and steel, fuel and power, and transport, this report gave a complete survey of the state and prospects of the economies of the participating countries. It contained a series of commitments on broad lines of policy, and a closely reasoned case for the "missing component" in European recovery, dollar aid.

Moreover, virtually the complete pattern of the organization of the O.E.E.C., of its methods of work, of the principles underlying its main activities, and, above all, of the basic relationship between it (as an organization of European countries) and the U.S. government were established in the *Grand Palais* in Paris during those few weeks of feverish activity in the hot summer of 1947. The Committee of European Economic Co-operation (C.E.E.C.), representing all the participating countries, was a forerunner of the Council of the O.E.E.C., its Executive Committee of the Executive Committee of the O.E.E.C., its four technical committees (with considerable

subsequent proliferation) of the "vertical" committees of the O.E.E.C. Special sub-committees set up by the C.E.E.C. on such general matters as balance of payments, internal finance, etc., were the prototypes of the "horizontal" committees of the O.E.E.C. which dealt with broad economic questions as distinct from the commodity or industrial sector scope of the "vertical" committees. The method of the questionnaire to ascertain participating countries' plans, expectations and prospects as well as their requirements, which was the basic raw material for the report of the C.E.E.C., became from the very beginning the central technique of the O.E.E.C.; and, although it no longer has the politico-economic significance that it had in the time of American aid, it remains to this day the method by which annual reports, as well as major *ad hoc* "exercises", are carried out.

In two important respects only did the O.E.E.C. pattern differ from that of its progenitor. The C.E.E.C. did not have a secretariat other than for housekeeping purposes. However, the small "central group" drawn from a few delegations, and the somewhat larger informal grouping of members of delegations that clustered round it (many of whom later on became associated with the O.E.E.C.'s central activities), developed a collective view and a co-operative spirit which can be said to have continued to inspire the O.E.E.C.'s international secretariat. These attitudes helped to create the admirable relations which have always existed between the secretariat and national delegations. The main credit in this respect, as in very much else that the organization achieved, must, however, go to Robert Marjolin, the outstanding first Secretary General which the O.E.E.C. was fortunate to have.

The other point of difference was this. In the C.E.E.C. the Chairmanship of the main Committee and that of the Executive Committee were held by the same country. It had originally been intended to follow this example in the organization of the O.E.E.C. In fact, however, this was not done and the difference was not without some significance during the early years of the O.E.E.C.'s life. Differences in national policies and attitudes were at times complicated, at least when they reached the ministerial level, by the fact that the day-to-day management was in the hands of the United Kingdom (through its Chairmanship, at the official level, of the Executive Committee), while the Council's Chairman was a minister of another nationality, alternately Belgian and Dutch.

II

The history of the O.E.E.C. in the ten years since its creation can be roughly divided into three phases: from 1948 to the autumn of 1950, from then until the middle of 1952, and the period since then.

The successes which the O.E.E.C. has to its credit in the first phase of its life, undoubtedly the period of greatest zest and most spectacular achievement, are quickly told. The development of the Organization in its first few months was extremely rapid and affords impressive proof of the speed with which institutions and techniques can be developed and perfected, so long as there exists the stimulus of a real job to be done. Notwithstanding the great scarcity of highly skilled administrative and technical manpower so keenly felt at that time in all European capitals, and in the United States as well, a remarkable assortment of talent was drawn into this work, whether in the central secretariat at the *Hôtel de Tabac* and, later, the *Chateau de la Muette*, in the national delegations in Paris, or in the rear-link machinery set up to deal with the problem of economic co-operation, in all national capitals. Most indicative, perhaps, of the importance attached to this work was the speedy collection and focusing of extremely able American personnel. The latter, whether in Paris, in Washington, in E.C.A. Missions in the participating countries' capitals or peripatetically in all three, was an especially important feature of this, the "heroic", period in European and European-American co-operation.

The first task of the O.E.E.C. (its assignment by the American Administration came as a staggering surprise), was to recommend to the U.S. government the division of aid to be received by Europe under the appropriation for the first fiscal year of the American Economic Co-operation Act. Within an incredibly short time a most intricate questionnaire had been despatched to participating countries and the replies received and analysed. Within a week the "Four Wise Men"—the original of a lengthening series of post-war *Dei ex machina*—managed, in the seclusion of a small hotel in the forest of Chantilly, to work out a suggested division of a sum of dollar aid substantially less than the original, unscreened, requirements of dollar assistance of the participating countries, but still amounting to nearly 5 billion dollars. In parallel, a system of intra-European credits, so-called drawing rights, was being worked out. By the 16th October, at a meeting at the ministerial level, the first annual programme of the O.E.E.C. was handed

over to Mr. Harriman, the United States Special Representative, and the first intra-European Payments Agreement was signed.

Not long thereafter, on the 30th December, 1948, the Organization was able to present to the U.S. government and to publish to the world the first of what has become a regular series of annual reports. This, the Interim Report on the European Recovery Programme, as all subsequent ones, was based on memoranda and tables submitted by individual countries. But, unlike its more recent successors, it was essentially a plan of action designed to sustain the annual programmes, which were the combined European bid for continued American assistance, by providing a framework of broad policy objectives to which participating countries remained committed. Its major contribution lay in the emphasis it placed upon the need for a three-pronged attack on the problem of European viability as measured by its ability to do without dollar aid: the creation of internal financial stability as the basis for a greater production effort, measures to save imports and to stimulate exports, and the development of intra-European trade.

Throughout 1949 the activities of the Organization proceeded in the pattern already set. A second division of aid which, largely because of the sudden deterioration in the United Kingdom balance of payments during 1949, gave rise to a good deal of friction and was in fact the last operation of its kind, a second intra-European Payments Agreement, and the continued and enlarged activities of the technical committees in various sectors of industry and on various commodities were the mainstay of the Organization's activity.

To these, however, was added an extremely important new activity based on a British initiative: namely, a plan for the progressive liberalization of trade within Europe. For the rest of this first phase, the programme for freeing trade within Europe from quantitative restrictions was a major feature of the activity of the O.E.E.C. It was greatly advanced by the establishment on the 19th September, 1950, of the European Payments Union, which, next to the distribution of American aid, has undoubtedly been the most substantial and lasting of the strictly "operational" achievements of the O.E.E.C. Its creation was foreshadowed in the Second Annual Report of the Organization in February, 1950. Its conception owed a great deal to American initiative; and the working out of its detailed provisions was greatly benefited by the technical competence and ingenuity of a handful of devoted American officials and economists.

III

No sooner had the E.P.U. Agreement been signed than the O.E.E.C. entered upon its second and more difficult phase. The Korean war had created new problems ranging from the severe scarcity of certain raw materials, particularly metals, to the financial consequences, both internal and external, of enlarged defence programmes and adverse terms of trade. During the last few months of 1950, the O.E.E.C. was making fresh strides in intra-European economic relations by taking 75 per cent. as the target for the abolition of quantitative restrictions and by agreeing to certain recommendations of the E.P.U. to improve the balance of payments of Germany (the first and the most notable example of the O.E.E.C.'s activity in relation to an individual member country). Nevertheless, it was torn by a fierce internal crisis due to the frustrating effects of a world-wide scarcity of raw materials. At once the limitations due to the regional character of the Organization became obvious and when, as a result of Anglo-American discussion, to which France later became a party, the International Materials Conference was set up in Washington, the O.E.E.C. had to content itself with no more than passive liaison with that body.

A second and even more serious crisis confronted the Organization in 1951 and the early months of 1952 as a result of the increasing impact of defence programmes upon the economies of the member countries as well as upon the United States and Canada. This development led to an increasing preoccupation of N.A.T.O. (itself undergoing a reorganization at that time) with economic matters. For some months the future of the O.E.E.C. hung in the balance. As the so-called "burden-sharing" exercise in N.A.T.O., designed to ascertain and, if possible, equalize the relative burdens of their defence efforts upon the economies of member countries, proceeded, and as the flow of American assistance and possible intra-European credits and transfers became increasingly linked to defence measures, it seemed to some countries that N.A.T.O. was the appropriate forum for all major economic questions, particularly since it had the United States and Canada as full members and could deal with these questions on the only relevant basis, an Atlantic one. Other members of the O.E.E.C. feared that if major economic work was undertaken in N.A.T.O., the O.E.E.C. would be emptied of its substance and the co-operation of the neutrals and Germany would be lost. In the end this did not happen. The report on the economic burden

of defence produced by N.A.T.O.'s Financial and Economic Board, perhaps the sharpest post-war document of its kind, remained the high-water mark of N.A.T.O.'s economic work. The symbol of the decision that O.E.E.C. was not expendable and, indeed, the best guarantee that it would not be so, was the decision to establish the headquarters of the reorganized N.A.T.O. in Paris. Once this was done, O.E.E.C.'s primacy in economic matters remained undisputed. A *modus vivendi* was worked out between the secretariats of the two bodies so far as economic matters were concerned and the delegations of those countries which were members of both bodies could apportion their manpower for the economic work in whatever manner suited them best.

IV

Since the middle of 1952, there has been much technical work of varying usefulness, but essentially of a marginal character. Occasionally, it is true, as at the time of the oil shortage during the Suez crisis, the existence of ready machinery has proved very helpful. The central activities, however, of the O.E.E.C. have been dominated, first, by intensive preparation for a collective approach towards the convertibility of currencies and, secondly, by the efforts of six of its member countries to form a closer economic union among themselves. Not much need be said about the first of these since, for the time being at least, it is not in the centre of discussion. It was once again a British initiative which, for over 2 years, provided the most active feature of the discussions and activities of the O.E.E.C. In the spring of 1953 the United Kingdom presented to the Organization ideas for a collective approach to a wider system of trade and payments. These ideas had been thrashed out a year earlier in Commonwealth Conferences; and when the plan for a unilateral adoption of convertibility by the United Kingdom was abandoned, the problem was put before the O.E.E.C. Much work was done during the remainder of 1953, throughout 1954, and in the summer of 1955 in working out on paper the consequences of a return to convertibility of a substantial proportion of the participating countries. This work culminated in the signature, on 29th July, 1955, by the Council of the O.E.E.C., of a Protocol which, while extending E.P.U. for another year, also provided for the establishment of a European Monetary Agreement to come into force when a specified proportion of E.P.U. members had made their currencies

convertible and had agreed to bring this Agreement into operation. Much of this work remained theoretical. Partly through changes in the economic and financial situation of the European countries themselves, partly and, indeed, mainly owing to a lack of response on the part of the U.S. government, the plans for a greater degree of convertibility of currencies, as then conceived, were abandoned. Nevertheless, the discussions influenced considerably the subsequent modifications in the E.P.U. The historical significance for O.E.E.C. and European economic development of the fact that the United Kingdom did not return to convertibility—as that of the earlier discussions concerning the relation between O.E.E.C. and N.A.T.O.—must remain one of the major "ifs" of post-war economic history.

V

More recently, O.E.E.C. has been under the increasing impact of the efforts of six of its member countries, those which in 1949 had subscribed to the Schuman Plan and had later created the European Coal and Steel Community, to extend economic integration among themselves. These tendencies have been in evidence for several years, but it is only recently that they have created an acute problem for O.E.E.C. They go back to the very inception of the European Recovery Programme. Already in 1947 a certain section of Continental opinion, led usually by some French spokesmen, had pressed solutions upon the other partners which were clearly inspired by a desire for rapid progress towards political federation in Europe. Whether in connection with the exploration of a European Customs Union (left on one side in 1947) or with the more pedestrian problems of the powers to be assigned to the international secretariat, there was a basic difference of approach which sometimes led to open disagreement between the United Kingdom and the Scandinavian countries who favoured inter-governmental methods, and some at least of the representatives of France, Belgium, the Netherlands and Italy, who advocated supra-national solutions. For a time the creation of the Coal and Steel Community seemed to threaten an open breach. In the end, however, perfectly smooth working relations were established between the two bodies and the O.E.E.C. was able to continue to devote itself, without any major diminution, to its general tasks in the field of European economic relations.

Since 1955 all discussions in the O.E.E.C. have been dominated by the problem of whether the further economic

integration of the "Six" can be reconciled in some form, such as the United Kingdom proposal for a Free Trade Area, with continued co-operation in the economic field among the larger number who form the O.E.E.C. In July, 1956, the O.E.E.C. Council set on foot the technical work relating to the Free Trade Area proposal, and in February, 1957, negotiations were opened. However, before these were concluded, the signing of the Treaty of Rome, with its prospect of a European Economic Community (towards which the first step has now been taken by the establishment of the European Economic Commission and the other common institutions of the Six) has raised a serious question-mark over the future of the O.E.E.C. In October, 1957, the decisive stage in the negotiations to find a common ground between the Six and their partners and to maintain the wider economic co-operation in Europe was reached. While the life of the O.E.E.C. as an institution may not depend upon the outcome of these prolonged negotiations, it is no exaggeration to say that its continued existence as a force in European economic affairs does. It is not inappropriate, on this tenth anniversary and while it is at this critical point in its life, to try to appraise its work to date.

VI

Against this sketchy historical background what are to be accounted as the achievements of the O.E.E.C.? First and foremost, it must be said that the recovery of Europe from the ravages of war would have been impossible without the Marshall Plan. National policies, national effort, and American help must take the main credit for what has been achieved. But in economic matters, even more than in other aspects of human society, intention, however good, and policy, however wise, have to be canalized through institutions; and if the O.E.E.C. had not existed something very like it would have had to be created sooner or later to give substance as well as moral impetus to the recovery programme. Looking back upon the often fierce discussions between the Europeans and the small group of American representatives giving "friendly aid" in 1947 and in the early days of the O.E.E.C., one European at least is prepared to admit the wisdom of the continual American pressure for greater institutionalization and for more explicit and detailed undertakings concerning co-operation as against the "*co-opération larvée*", the reliance on the invisible hand, which, in international matters at least, appeared at the time to be the

European guiding principle. Without the dollars and the goods which they represented, neither production nor trade could have been restored so quickly to their pre-war level and so quickly developed far beyond it. Without them, the European standard of living could certainly not have been raised to its present levels. But without an institution—that is to say, without a constitution and, over and beyond it, a network of people and particular methods of work—the beneficial effects of American assistance would have taken far longer to be felt.

In addition to its major rôle in making American aid more speedily fruitful and multiplying its effect by intra-European payments arrangements, the O.E.E.C. has many other achievements to its credit. Most direct and voluminous evidence of its work can be found in the large quantity of literature that it has produced on a variety of technical subjects. Admittedly these are of unequal value. Many are of no great moment, and some, as in all international organizations, may represent a wastage of energy. But in a large number of technical fields, ranging from surveys of oil refining capacity in Europe to technical handbooks on the advantages of hybrid maize, from studies of retail distribution in the United States to those covering tourism in Europe, the O.E.E.C. has produced useful additions to economic literature. These studies are partly the work of the secretariat, partly, and perhaps mainly, of experts, government officials, as well as those drawn from industry and trade, brought together in Paris in the technical committees or in *ad hoc* working parties. Much of this work may not be of a kind that it would be worth while to undertake or maintain for its own sake; and if the O.E.E.C. were to lose its main rôle in economic affairs, it is not certain whether many of these ancillary activities could long continue. But, while they do, they undoubtedly provide a valuable supplement to what is being done elsewhere.

Of perhaps more lasting and more fundamental value is the work of the O.E.E.C. in the general field of economic and financial analysis. Its annual reports have justly achieved an assured place in the economic literature of Europe. As the second report, perhaps the most pregnant that it has issued, said of itself, it " is not a mere exercise in research and analysis . . . it is a statement agreed by the governments of 18 participating countries outlining their problems and the manner in which they propose to deal with them". Other bodies may have produced more highly-skilled, more subtle, and perhaps more profound, economic analyses; but these lack something which the "negotiated" and, therefore, diluted documents

produced by the O.E.E.C. have: the agreement of the governments concerned.

However, the importance of these documents has tended to change. In the early years they were vital, partly as a basis for continuing American aid, partly as a framework for the future activities of the Organization, partly as a declaration of intentions of which the conscience of participating governments could always be reminded when policies were embarked upon which were thought to be harmful to the collective interest. As time has gone on and as, significantly, more of the work involved in writing the annual reports has been undertaken by the professional technicians of the O.E.E.C. secretariat, the reports have tended to approximate more to the research products of other organizations.

Besides its annual reports, the O.E.E.C. has been responsible for a large number of documents on particular aspects of general economic policy, produced sometimes by its own committees, sometimes by a group of distinguished outside experts, and sometimes by the secretariat. To mention only a few, it has published reports on internal financial stability, on foreign investment, on national income comparisons, many of which have become minor classics in economic literature.

VII

In the outcome, however, it is for its contribution to European, and, therefore, world, economic recovery and advance that the work of the O.E.E.C. must be assessed. Here, three solid achievements will remain for ever to its credit. First, it initiated and promoted the freeing of trade from war-time and, indeed, many pre-war restrictions. Secondly, it created a payments mechanism in Europe without which all the efforts for freeing trade would have been in vain. This provided a source of much needed mutual credits and enabled continual progress to be made towards greater transferability of currencies within Europe and (through the membership of the United Kingdom) between Europe and the whole of the sterling area. It also provided a shield between European currencies and the dollar and by this very fact made it possible for greater progress towards convertibility to be made. Thirdly, it created, through the programming technique of its early division-of-aid days, a powerful machinery for what has since come to be known as the harmonization of economic policies.

It is true that the O.E.E.C. was never seriously tempted to embark upon any grandiose scheme of central planning for all its members. Some of its members have even complained from time to time about the Organization's lack of enterprise in these matters, for example, when suggestions for the co-ordination of investment in participating countries or for the creation of an investment bank linked to trade liberalization proposals were under discussion. The screening of dollar import programmes for the purpose of the division of Marshall Aid was never pushed to the point of becoming an attempt to impose rigid common criteria. Fortunately, the leaders in the O.E.E.C., whether in the secretariat or in the national delegations, were only too well aware of the narrow limits within which paper plans elaborated in Paris could have any effective reality in national capitals.

Nevertheless, the technique of questionnaire and the mutual analysis of replies, the cross-examination of one's expectations and plans by one's peers, have had a powerful effect in moulding national policies. At the very least, they have created a general readiness to "look over one's shoulder" before taking any major step in economic policy, of asking what consequences it might have for one's partners and how any adverse results might be mitigated. Subtler in its working, often as powerful, and sometimes even more so, than more rigorous constitutional obligations, this habit of consultation and co-operation has resulted in a real limitation of national sovereignty in economic matters. Pressure through the O.E.E.C. has on a number of occasions stopped "backsliders"; and ministers and officials have often testified to the support which they have derived from the work of O.E.E.C. when advocating policies of international co-operation in their own countries.

Whatever the future may hold, these are lasting achievements. That they are not greater than they are is due to the limitations to which the Organization is necessarily subject owing to its restricted membership (notwithstanding the undoubted value of Canadian and American association), even more than to the fact that it had its origins in a specific, emergency, operation. The O.E.E.C. has always been conscious of the wider economic problems of the world. Controversy has raged from time to time over the part that it might play, for example, in relation to tariffs or world-wide monetary matters; but in the end it has had to content itself with its own preoccupations, even when wider institutions, upon which the world's hopes of major post-war reorganization have rested,

were relatively inactive. This is not to say that the O.E.E.C. has not played some part: it has never hesitated to emphasize, for example, the effect upon European recovery of U.S. policy in the field of tariffs, and one cannot deny that it has often raised its voice in these matters to good purpose. In the end, however, in the measure that the urgency of strictly European problems has grown less, the intractable problems of the wider world have obtruded more and the limits of O.E.E.C.'s scope have been more keenly realized.

VIII

Perhaps more lasting, if less tangible, an achievement has been the training in the practice of the new techniques of co-operation developed by the O.E.E.C. which has been afforded to a very large number of people through their work in the Organization. An ever increasing number of civil servants, permanent or temporary, diplomatists, economists, and business-men in all the participating European countries, in Canada and in the United States, have been drawn into this machinery. However short their contact with it, they have been changed by it.

For those who have had the privilege to be associated with the central machine of O.E.E.C., this experience has for ever profoundly affected the manner in which they view and tackle the processes of international relations. They now hold in common an expertise in certain techniques with large numbers of fellow workers in many countries. But more important than that, however fierce the negotiations and the controversies in which they were engaged, they will have carried away from their work in the O.E.E.C. a common attitude. For they have learned that it is not impossible zealously to defend a particular national interest and yet to look upon the problems to be solved as common problems. No doubt this attitude is born of a basic political will; and no doubt, if that will is absent, the attitude cannot long survive. But so far, at least, it has survived and has had a most beneficial influence in many fields other than the O.E.E.C. itself. It may not be out of place in writing from London about this decade to mention especially the contribution which the European Recovery Programme has made to increasing the intimacy of Anglo-American relations.

For the European countries themselves, it can, at any rate, be said that Ernest Bevin's hope, expressed in 1947, that this work would be acclaimed "as a unifying effort never equalled in Europe's long and troubled past", has not been disappointed.

IX

Finally, an even wider reflection may be permitted on an occasion like this. It is, alas, not often in international relations, and particularly in economic matters, that the recognition of what needs to be done, and the power and readiness to do it, go together. In those days of the late spring of 1947 when the Marshall Plan was conceived in Washington they did; and the effects of this combination have been beneficial beyond the most sanguine expectations of the Plan's authors. If the more fundamental economic imbalances in the world have not yet been removed, it is certainly not their fault. Much remains to be done; and one may perhaps take hope from this retrospect that, once again, wisdom, power and will may be united and find as effective an expression.

Eric Roll.

London.
March, 1958.

Publications Received

ROBERT TORRENS AND THE EVOLUTION OF CLASSICAL ECONOMICS by Lionel Robbins (Macmillan & Co., 36/-)

Torrens' career covers the main period of evolution of English classical economics after Adam Smith. A contemporary of Malthus and Ricardo, he later played an important part in the controversies of the 'thirties, 'forties and 'fifties regarding colonization, banking and commercial policy.

The purpose of Professor Robbins' book is twofold: to describe Torrens' economic works and to survey the intellectual *milieu* in which he lived. An extensive bibliographical appendix gives synopses of the contents of all his known publicatons.

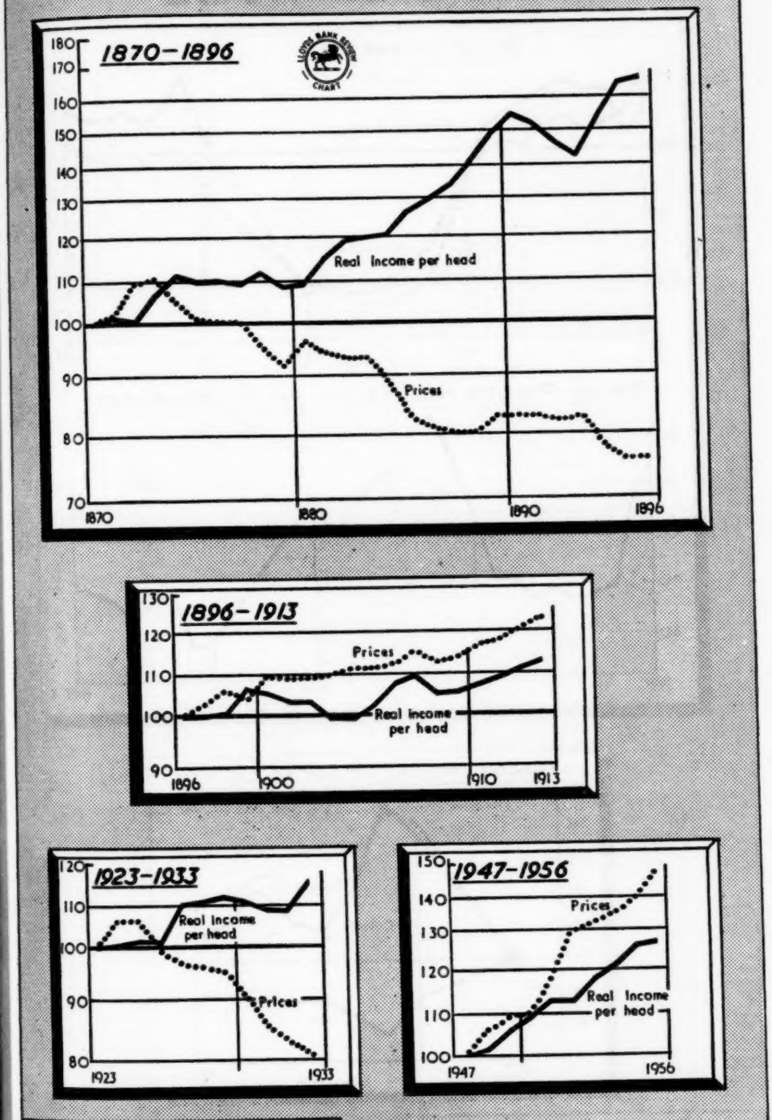
ECONOMIC ANALYSIS AND POLICY IN UNDERDEVELOPED COUNTRIES by P. T. Bauer
(Duke University Commonwealth-Studies Centre, $3.00)

This valuable addition to the literature on under-developed countries has a truly Anglo-American stamp: it comprises three lectures delivered by a Fellow of a Cambridge College to a centre devoted to Commonwealth studies in an American University. In the first lecture Mr. Bauer considers the scope and limitations of economics in the study of under-developed countries, in the second he reviews a number of important economic aspects and developments in these countries and concludes with an examination of some issues of policy.

HIRE PURCHASE IN A FREE SOCIETY Edited by Ralph Harris and Arthur Seldon (Institute of Economic Affairs, 7/6)

There has long been a need for an up-to-date study of the operation, finance and impact of hire purchase as it has developed in Britain. After a brief historical survey, the authors of this book consider the rôle of the specialized finance companies in some detail, with special attention to their methods of raising funds and techniques of doing business. The following section on "Principles and Policy" deals with such questions as the market for hire purchase, whether h.p. is inflationary, government controls, and "the philosophy of consumer credit in a free society."

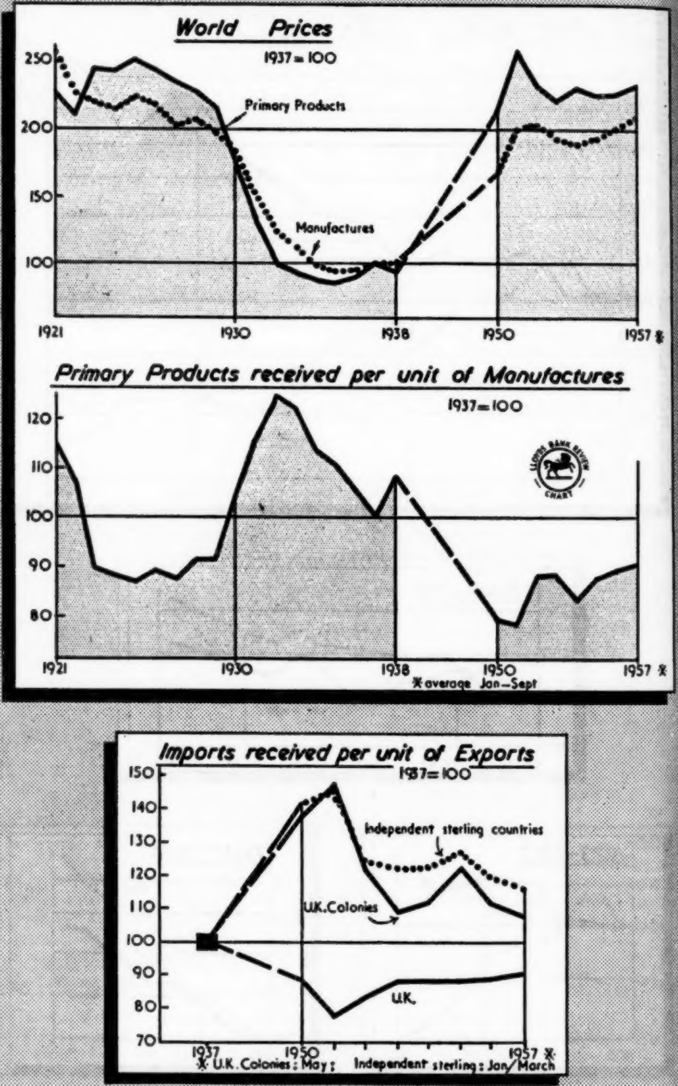
PRICES AND GROWTH



SOURCES: Economic Journal, Mar, 1948 (A.R. Prest). National Income Blue Book, 1957.

It will be seen that real income was rising at least as rapidly in the 1880's, with prices falling, as during the last ten years of inflation. (The charts being drawn on a logarithmic scale, the slope of the lines indicates the same percentage movement in all four charts).

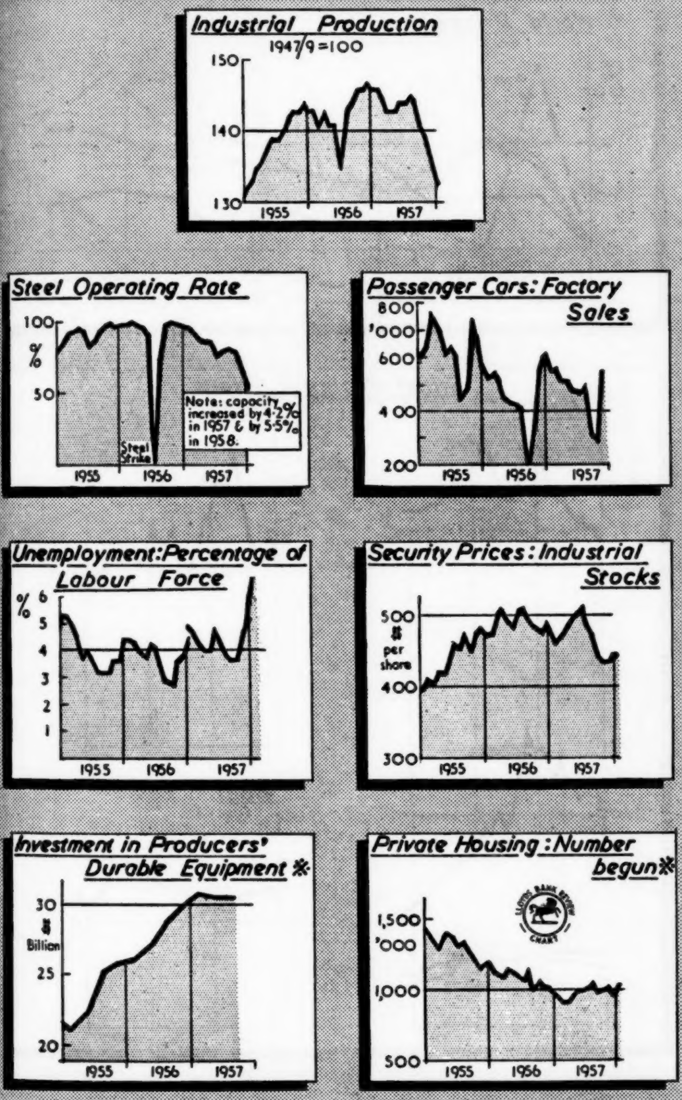
TERMS OF TRADE



SOURCES: The Manchester School (W. A. Lewis) May, 1952
U.N. Bulletin of Statistics
I.M.F. Financial Statistics

In spite of the recent declines in primary commodity prices, the industrial countries are still receiving far less in exchange for a given quantity of manufactured exports than in pre-war years.

U.S. RECESSION

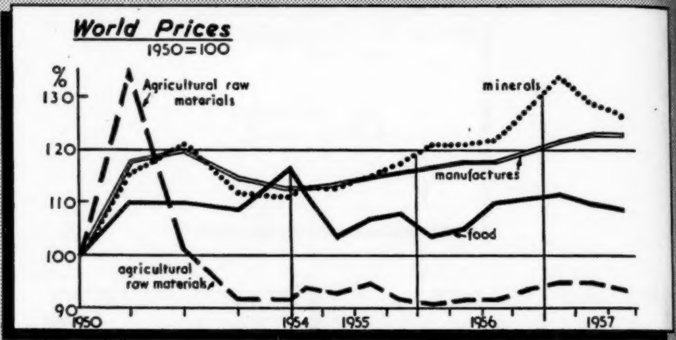


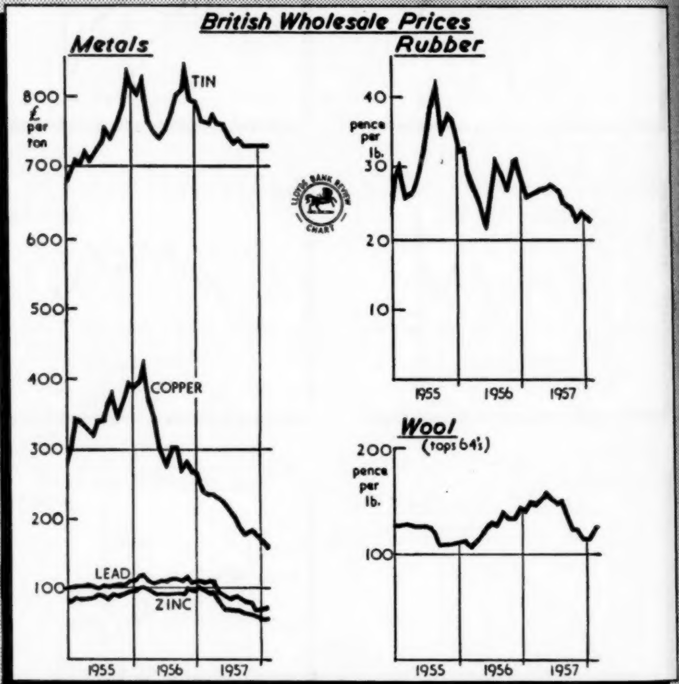
SOURCE: Survey of Current Business

※ Seasonally adjusted annual rates

The above charts bring out some of the facets of the current recession in American business activity. By February industrial production had fallen 17 points from the peak of December, 1956, while in recent weeks steel production has been running at little over 50 per cent. of capacity.

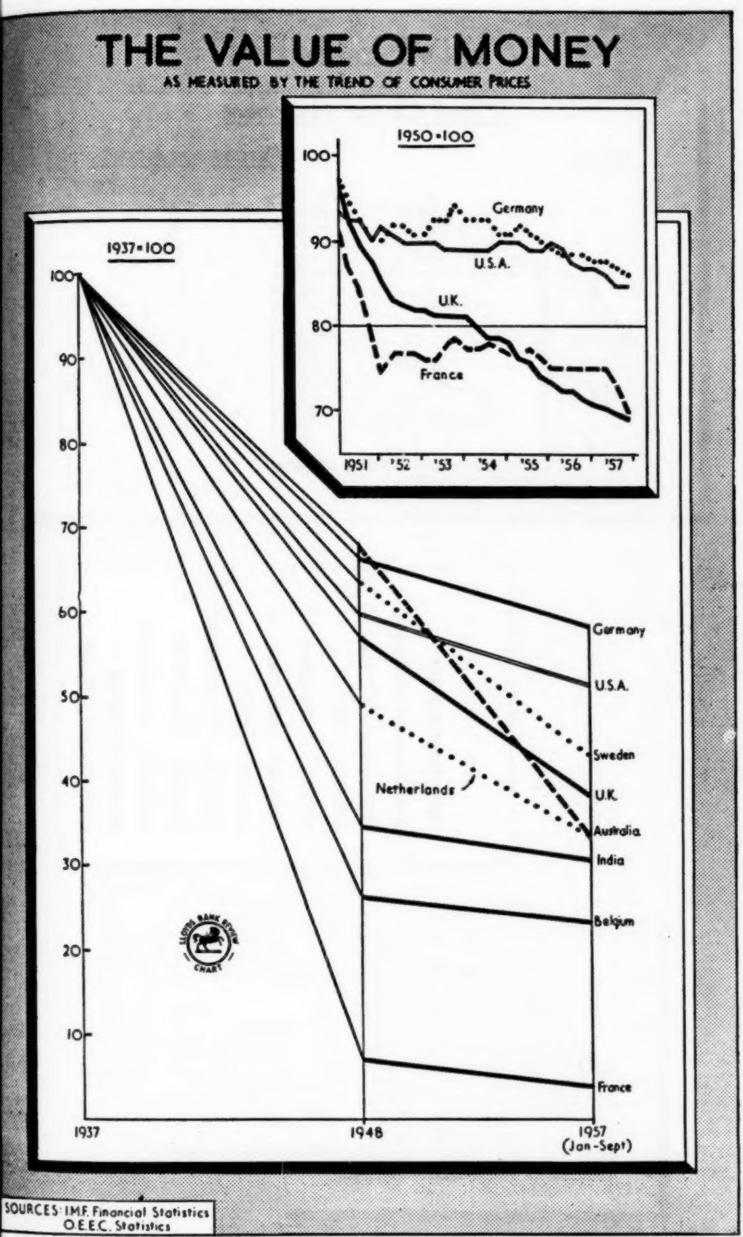
PRICES





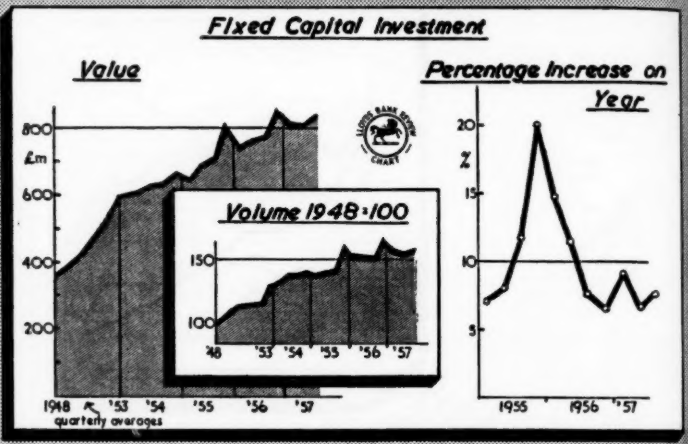
SOURCES: U.N. Bulletin of Statistics
Economist

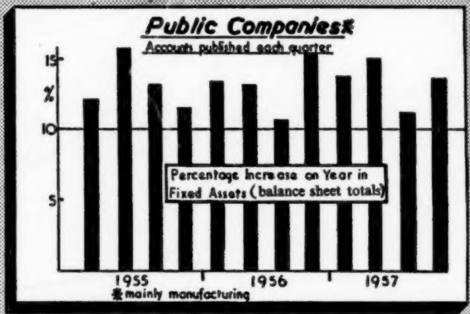
While world prices of manufactures levelled off last year, there was a weakening in prices of food and raw materials. This has been noticeably evident in metal prices; in mid-March the price of copper was 60 per cent. below the peak touched in March, 1956.

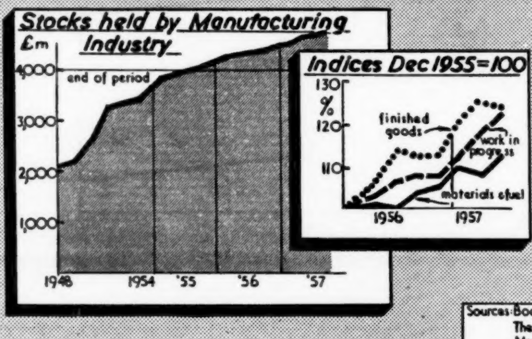


In the twenty years to 1957, the value of the pound fell by over three-fifths, compared with a decline of not quite 50 per cent. for the American dollar. Since 1950, the depreciation in the pound's value has been greater than that for either the dollar or the deutschemark.

INVESTMENT

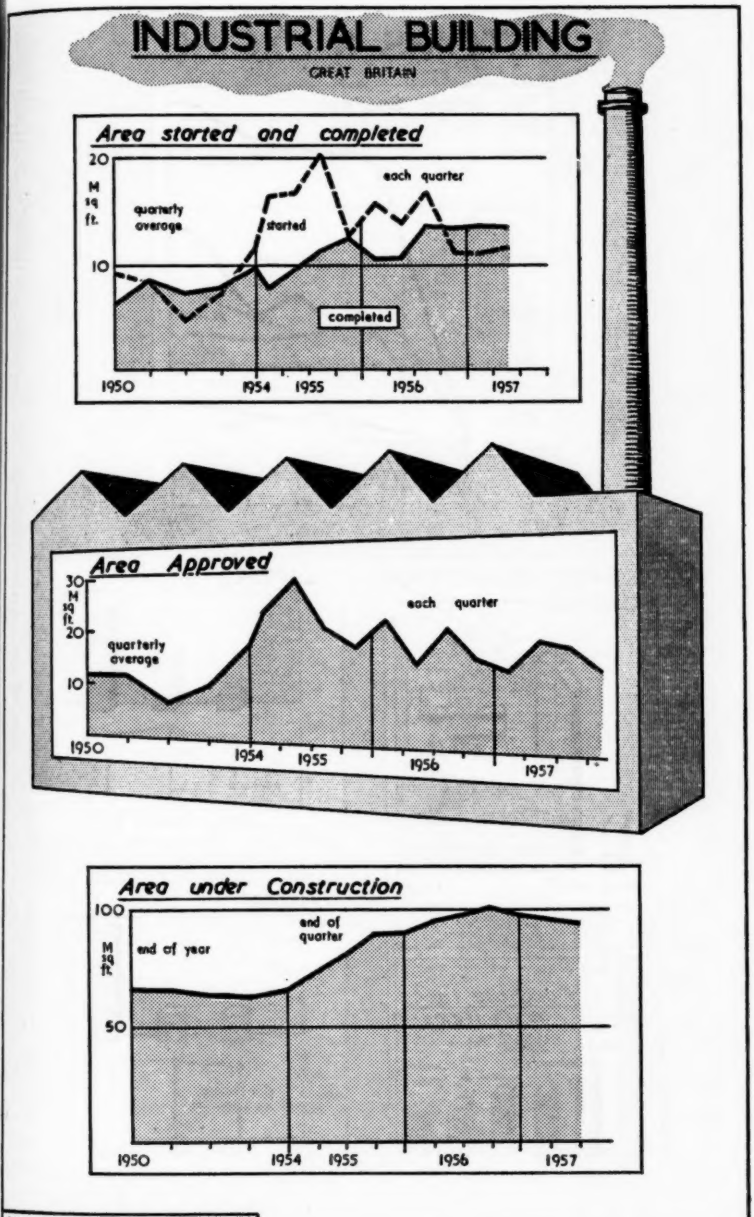






Sources: Board of Trade Journal
The Economist
Monthly Digest of Statistics

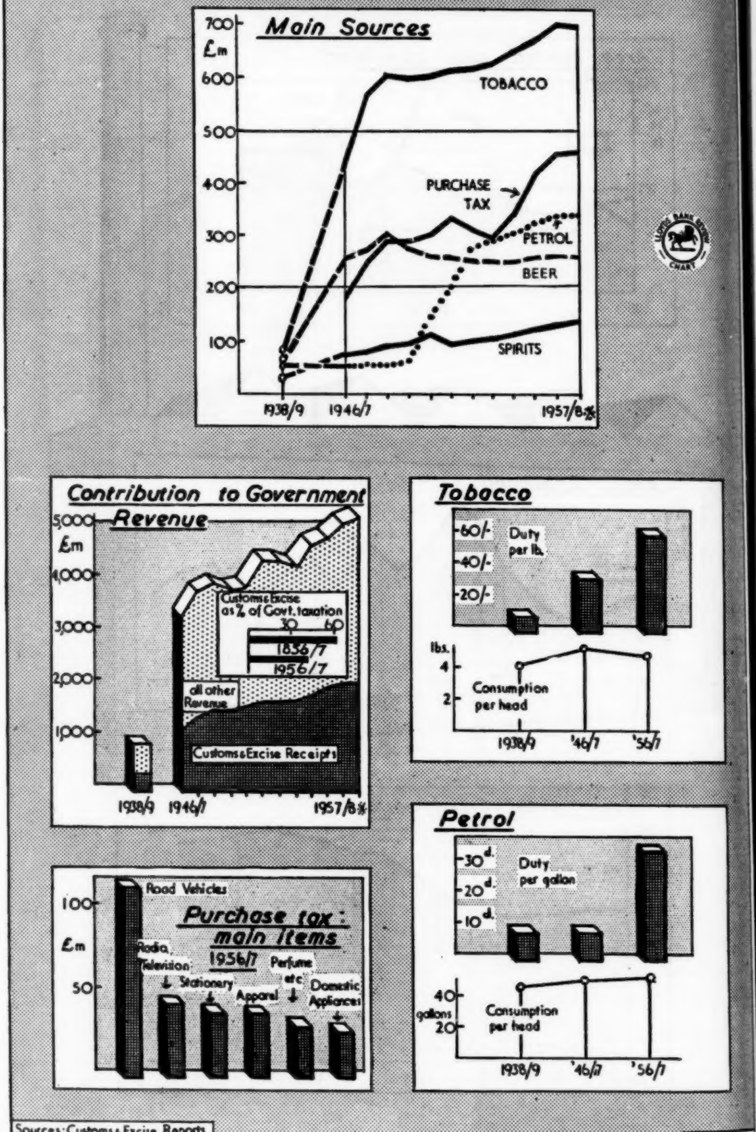
Up to the third quarter of last year, at any rate, the credit squeeze had not meant any actual reduction in investment. Fixed capital investment was nearly 8 per cent. higher on the year and manufacturing stocks were still rising (though there was no further increase in the final quarter of the year).



SOURCE: Monthly Digest of Statistics

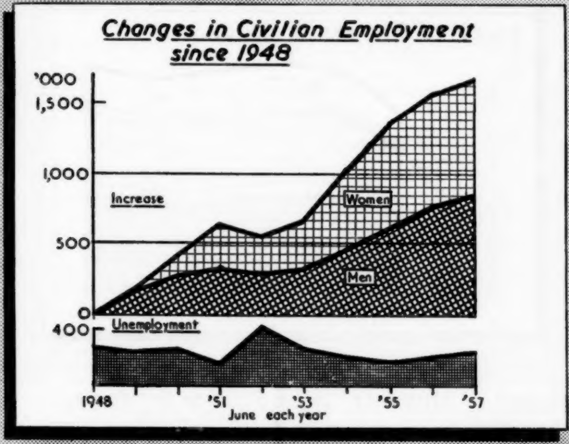
Recently, more factories have been completed than new ones started and industrial building approvals have fallen well below the mid-1955 peak level.

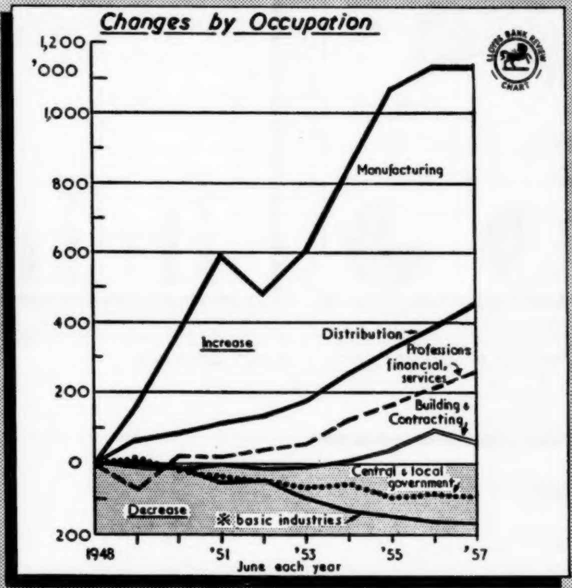
CUSTOMS & EXCISE



Of every 20/- of government ordinary revenue in 1956/7, 8/2d. was derived from customs and excise duties, the tobacco duty alone contributing 2/9d. Tax on road vehicles accounted for one quarter of purchase tax receipts.

MANPOWER

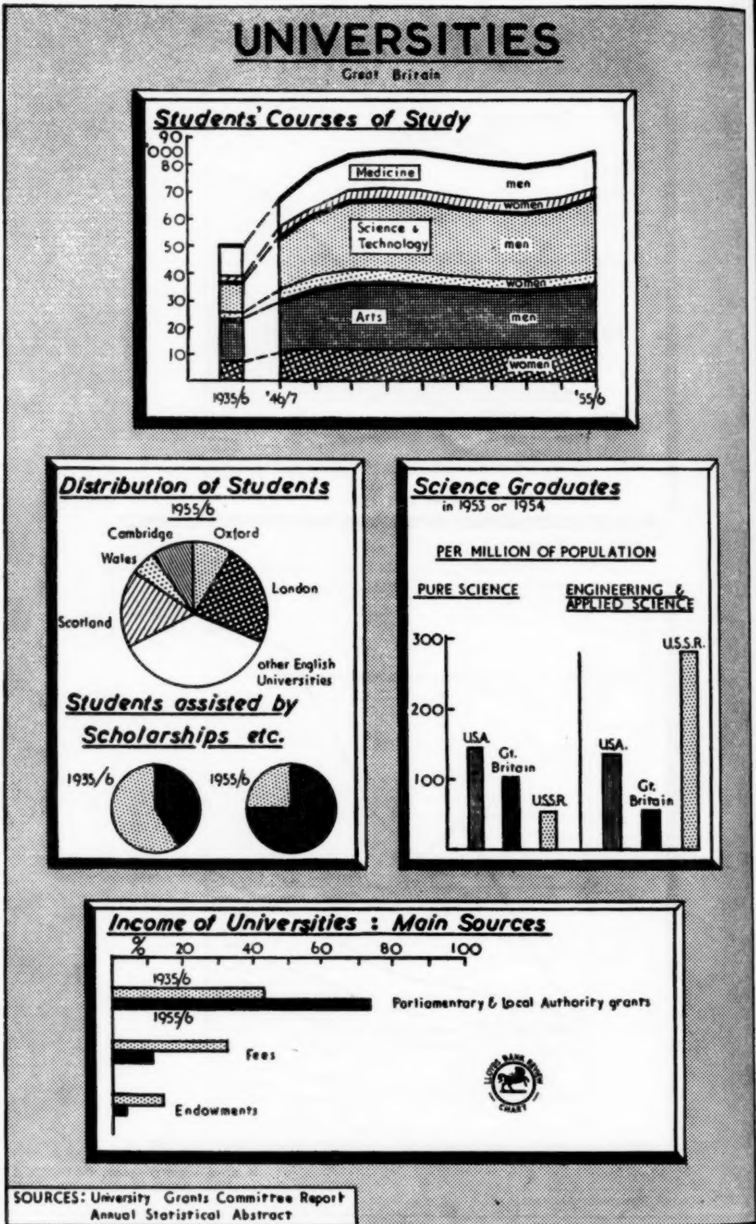




SOURCE: Annual Statistical Abstract

※ mining & quarrying; gas, electricity, water; transport & communication; agriculture & fishing.

Over the nine years to June, 1957, civilian employment increased on balance by nearly 1.7 millions, almost equally divided between men and women. Manufacturing industry took two out of three of the additional workpeople, and distribution one out of four. The number in "basic industries", on the other hand, declined by 167,000.



University students have increased by over two-thirds in number since pre-war, and three out of every four are now assisted in one way or another. Twice as many students study science and technology as in the 'thirties.